

**IN THE INCOME TAX APPELLATE TRIBUNAL
“C”BENCH: BANGALORE**

**BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER
AND
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER**

ITA Nos.413 to 416/Bang/2021
Assessment Years :2014-15 to 2017-18

K.R. Pradeep 20, Eden Park, 101, I Floor Vittal Mallya Road Bangalore 560 001 PAN NO :AALPP7910M	Vs.	Deputy Commissioner of Income-tax Central Circle-1(3) Bangalore
APPELLANT		RESPONDENT

Appellant by	:	Mrs. Girija G.P., Advocate
Respondent by	:	Shri Pradeep Kumar, DR

Date of Hearing	:	11.11.2021
Date of Pronouncement	:	22.12.2021

ORDER

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

The assessee has filed these appeals challenging the orders passed by Ld CIT(A)-11, Bengaluru and they relate to the assessment years 2014-15 to 2017-18. All these appeals were heard together and hence they are being disposed of by this common order, for the sake of convenience.

2. In all the years, the assessee is contesting the disallowance made u/s 14A of the Income-tax Act,1961 [‘the Act’ for short] on merits. In AY 2014-15, the assessee is also contesting the validity of addition made, in the absence of incriminating material.

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3. The facts relating to the case are discussed in brief. The assessee is a Chartered Accountant and he was subjected to search operations u/s 132 of the Act on 21-9-2017. Consequent thereto, the present assessments were completed u/s 153A r.w.s 143(3) r.w.s 153D of the Act. In all these years, the AO has made addition u/s 14A of the Act read with Rule 8D of IT Rules.

4. We shall first take up the appeal filed for AY 2014-15. The legal contention raised by the assessee in this year is that the assessment of the AY 2014-15 had been completed prior to the initiation of search and hence the said assessment shall not abate in terms of provisions of sec.153A. In that case, the AO could have made addition in AY 2014-15 only on the basis of incriminating materials found during the course of search. It is the contention of the assessee that no incriminating material relating to AY 2014-15 was found during the course of search. Hence the AO should not have made any addition in AY 2014-15. In support of this legal contention, the Ld A.R placed her reliance on the decision rendered by Hon'ble High Court of Delhi in the case of PCIT vs. Meeta Gutgutia (395 ITR 526)(Delhi) and certain other decisions during the course of hearing. Subsequently, the Ld A.R furnished a copy of decision rendered by jurisdictional Hon'ble Karnataka High Court also in the case of PCIT vs. Delhi International Airport P Ltd (ITA No.322/2018 & others dated 29th September, 2021).

5. The Ld A.R submitted that the return of income for AY 2014-15 was filed by the assessee on 29-11-2014. The same was taken up for scrutiny and the assessment was completed u/s 143(3) of the Act on 28-12-2016. The Ld A.R submitted that the copy of said assessment order is placed at pages 28 -29 of the paper book. The Ld A.R submitted that the above said assessment order shall not abate, since it has been completed prior to the initiation of search

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on 21-09-2017. Accordingly, she submitted that the AO could make any addition only on the basis of incriminating material found during the course of search. She submitted that the AO has made addition u/s 14A of the Act in the present assessment order passed u/s 153A r.w.s 143(3) of the Act and there is no incriminating material available in support of the same. Accordingly, she submitted that the AO was not right in law in making the addition u/s 14A of the Act.

6. We heard Ld D.R on this legal issue and perused the record. It is the contention of the assessee that, in an unabated assessment year, the AO could make any addition in the absence of any incriminating material found during the course of search. In AY 2014-15, the only addition made by the AO is the disallowance of expenses u/s 14A of the Act. It is an admitted fact that the said addition do not relate to any incriminating material found during the course of search. Hence, the question that arises is whether the AO could make any addition in an unabated assessment year in the absence of any incriminating material.

7. The above question has been recently answered by the jurisdictional Hon'ble Karnataka High Court in the case of PCIT vs. M/s Delhi International Airport (P) Ltd & others (ITA No.322/2018 & others dated 29-09-2021) and it has been held that the AO, while passing order u/s 153A r.w.s 143(3) of the Act, ordinarily cannot disturb the assessment/reassessment order which has attained finality, unless the materials gathered in the course of proceedings establishes that the finalized assessments are contrary to the material unearthed during the course of search. We notice that the Hon'ble Karnataka High Court also considered the decision rendered by it in the case of Canara Housing Development Company (supra) and also the decision rendered in the case of IBC

Knowledge Park (P) Ltd (385 ITR 346)(Kar) while rendering its decision as stated above. The relevant observations made by Hon'ble jurisdictional High Court in the case of Delhi International Airport (P) Ltd (supra) are extracted below:-

“26. *In the light of these judgments, we have analyzed Section 153A of the Act vis-à-vis the material on record. Strong reliance was placed by the Revenue on the **Canara Housing Development Company** supra, in support of the contention that search under Section 132 of the Act is sine qua non for initiation of proceedings under Section 153A of the Act but it is not dependent on any undisclosed income being unearthed during search. There is no cavil on this proposition that search under Section 132 or requisition under 132A is a condition precedent for invoking Section 153A of the Act, the assessing officer can assess or re-assess the total income with respect to six assessment years separately immediately preceding the assessment year relevant to the previous years in which the search was conducted or requisition was made but the controversy rests on whether the incriminating material is a condition precedent for invoking section 153A?*

27. *It is discernable from the memorandum explaining the provisions in the Finance Bill 2003 [260 ITR [ST] 14 at page 219] than it is to overcome the difficulty leading to prolonged litigation inasmuch as "undisclosed income", the legislature by Finance Act, 2003, decided to discard Chapter XIV-B provisions and introduced Sections 153A, 153B and 153C in the Act. Section 153k would contemplate that on initiation of proceedings under said Section 153A, the assessment/reassessment proceedings that are pending on the date of conducting search under Section 132 or making requisition under Section 132A of the Act stand abated and not the assessment/reassessment already finalized. The CBDT Circular No.8/2003 dated 18.09.2003 clarifies that on initiation of proceedings under Section 153A of the Act, the proceedings pending in appeal, revision/application against finalized assessment shall not abate. It is clarified in the said CBDT Circular that the then existing provisions of Chapter XIV-B provided for a single assessment of the undisclosed income of a block period, which means the period comprising previous years relevant to six assessment years preceding the previous year in which the search was conducted and also includes the period up to the date of the commencement of such search, and laid down the manner in which such income is to be computed. The new Section 153A provides the procedure for completion of assessment where a search is initiated under Section 132 or books of account or other documents or any assets are requisitioned under Section 132A, after May 31st 2003. In such cases, the assessing officer shall issue notice to such person requiring him to furnish within such period as may be specified in the notice, return of income in respect of six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under Section 132 or requisition*

was made under Section 132A. Thus, it is clarified that the appeal, revision or rectification proceedings pending on the date of initiation of search under Section 132 shall not abate.

28. *Section 153B provides for the time limit for completion of search assessments.*

29. *Section 153C provides that where an Assessing Officer is satisfied that any money, bullion, jewellery or other valuable article or thing or books of account documents seized or requisitioned belong or belongs to a person other than the person referred to in Section 153A, then the books of account, or documents or assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against such other person and issue such other person notice and assess or reassess income of such other person in accordance with the provisions of section 153A.*

30. *Thus, it is clear that the Assessing Officer while passing the order under Section 153A read with Section 143[3] of the Act, ordinarily cannot disturb the assessment/reassessment order which has attained finality, unless the materials gathered in the course of the proceedings establishes that the finalized assessments are contrary to the material unearthed during the course of 153A proceedings, as held by the Co-ordinate Bench of this Court in the case of **IBC Knowledge Park (P) Ltd.**, supra. A concluded assessment could not be disturbed without there being any basis for doing so which is impermissible in law. Even in case of a searched person, the same reason would hold good. As observed in **Canara Housing Development Company** supra, the Assessing Officer is empowered to assess or reassess the total income of six assessment years i.e., the income which was returned in the earlier return, the income which was unearthed during search and also any income which was not disclosed in the earlier return or which was not unearthed during the search by separate assessment orders but in our considered view the completed assessments should be subject to the safeguards provided in **IBC Knowledge Park (P) Ltd.** supra.*

"54. On a consideration of the relevant sections as well as judicial precedent referred to above, what emerges is that, Section 158BD of the Act deals with undisclosed income of a third party. However, insofar as the incriminating material of the searched person or other person detected during the course of search is concerned, the same can be considered during the course of assessment. Further, such incriminating material must relate to undisclosed income which would empower the Assessing Officer to upset or disturb a concluded assessment of the other person. Otherwise, a concluded assessment would be disturbed without there being any basis for doing so which is impermissible in law. Even in case of a searched person, the same reason would hold good as in case of any other person. As observed by us, detection or the existence of incriminating material is a must for disturbing the assessment already made and concluded. But, at the same time, such can be at three stages: one, at the stage when the reassessment is initiated, the second, at the stage during the course of reassessment and third, at a stage where the reassessment is

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altered by a different assessment in respect of searched person or in respect of third party. In this regard, reference may be made to the decision of Apex Court in case of M/s. Calcutta Knitwear (supra) and based on the said decision, the CBDT has also issued circular dated 31.12.2015 vide No.24/ 2015.The relevant extract of the circular for ready reference can be extracted as under:

.....

As regards the pending assessments are concerned only one assessment shall be made separately for each assessment year on the basis of the income unearthed during search and any other material existing or brought on the record of the Assessing Officer. Even in the absence of any incriminating material abated assessment or reassessment could be done. The returns filed under Section 139 of the Act gets replaced by the returns filed under Section 153A[1] of the Act. Pending proceedings in appeal, revision/application shall not abate subsequent to initiation of Section 153A proceedings. Further, recording of satisfaction under Section 153A may not be necessary unlike Section 153C of the Act which mandates recording of satisfaction.

For the reasons aforesaid, substantial question of law in ITA Nos.322/2018 to 324/2018, 354/2018 and 355/2018, substantial question of law No.1 in ITA Nos.380/2018, 382/2018 to 385/2018 and 197/2021 to 199/2021 and substantial question of law Nos.1 and 2 in ITA No.381/2018 are answered in favour of the assessee and against the revenue.

Substantial question of Law No.2 in ITA Nos.380/2018, 383/2018 to 385/2018 is squarely covered by the ruling of the coordinate Bench of this Court in ITA No.352/2018 and connecter! matters (DD 25.05.2021) wherein the said substantial question of law has been answered in favour of the assessee and against the Revenue.

Substantial question of law No.2 in ITA No.382/2018 and substantial question of law No.3 in ITA Nos.380/2018, 383/2018 to 385/2018 does not arise for our consideration since the same are not pressed by the Revenue.

Appeals stand disposed of accordingly.”

In view of the binding decision rendered by the jurisdictional Hon'ble Karnataka High Court in the case of Delhi International Airport (P) Ltd (supra), the addition made by the AO u/s 14A of the Act in AY 2014-15 is liable to be deleted, as the said assessment year fall under the category of unabated assessment and further no incriminating material supporting the above said addition was found during the course of search. Accordingly, we set aside the

order passed by Ld CIT(A) for assessment year 2014-15 and direct the AO to delete the addition made u/s 14A of the Act.

8. We shall now take up appeals filed for assessment years 2015-16 & 2016-17 since the facts prevailing in those two years and the applicable law are identical in nature. These two years fall under the category of abated assessments and hence the A.O. is entitled to make addition even in the absence of any incriminating material. In both these years, the A.O. has made addition u/s 14A of the Act. The relevant details are tabulated below:-

<i>Asst.year</i>	<i>Dividend income (Rs.)</i>	<i>Long term capital gain (Rs.)</i>	<i>Total exempt income (Rs.)</i>	<i>Disallowed by assessee (Rs.)</i>	<i>Disallowed by A.O. (Rs.)</i>
2015-16	1,33,55,149	3,33,65,413	4,67,20,562	Nil	2,05,58,974
2016-17	1,46,87,340	1,19,06,736	2,65,94,076	Nil	2,17,08,095

9. The total disallowance made by the A.O. under Rule 8D(2) are tabulated below:-

<i>Asst. year</i>	<i>Under Rule 8D(2)(i) (Rs.)</i>	<i>Under Rule 8D(2)(ii) (Rs.)</i>	<i>Under Rule 8D(2)(iii) (Rs.)</i>	<i>Total (Rs.)</i>
2015-16	Nil	1,42,04,022	63,54,952	2,05,58,974
2016-17	Nil	1,46,58,490	70,49,605	2,17,08,095

10. The Ld. A.R. submitted that the AO was not justified in making disallowance out of interest expenditure under Rule 8D(2)(ii), since the own funds available with the assessee are in excess of the value of investments in both these years. In that kind of situation, the presumption is that the assessee has used own funds to make investments. Hence no part of interest expenditure could be related to the exempt income. In support of this proposition, the Ld A.R placed her reliance on the decision rendered

by Hon'ble Karnataka High Court in the case of Micro Labs Ltd.
383 ITR 490.

11. We heard Ld. D.R. on this issue and perused the record. The own funds available with the assessee and the value of investments held by him in the two years relevant to assessment year 2015-16 & 2016-17 are tabulated below:-

(Rs. in Crores)

<i>Asst. year</i>	<i>Own funds as on beginning of year</i>	<i>Own funds as at end of year</i>	<i>Value of investments as at end of year</i>
2015-16	187.00	229.58	145.61
2016-17	229.58	238.53	136.37

A perusal of the above said table would show that the own funds available with the assessee is in excess of value of investments on both the years. Hence the presumption is that the investments have been made out of own funds. Accordingly, no disallowance out of interest expenditure under Rule 8D(2)(ii) is called for. The above said legal proposition has been upheld by Hon'ble Karnataka High Court in the case of Micro Labs Ltd. (supra) with the following observations: -

"40. We have heard the rival submissions. A copy of the availability of funds and investments made was filed before us which is at pages 38 to 42 of the assessee's paperbook and the same is enclosed as ANNEXURE-III to this order. It is clear from the said statement that the availability of profit, share capital and reserves & surplus was much more than investments made by the assessee which could yield tax free income.

41. The Hon'ble Bombay High Court in Reliance Utilities & Power Ltd. 313 ITR 340 (Bom) has held that where the interest free funds far exceed the value of investments, it should be considered that investments have been made out of interest free funds and no disallowance u/s. 14A towards any interest expenditure can be made. This view was again confirmed by the Hon'ble Bombay High Court in CIT v. HDFC Bank Ltd., ITA No.330 of 2012, judgment dated 23.7.14, wherein it was held that when investments are made out of common pool of funds and non-interest bearing funds were more than the investments in tax free securities, no disallowance of interest expenditure u/s. 14A can be made.

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42. In the light of above said decisions, we are of the view that disallowance of interest expenses in the present case of Rs.49,42,473 made under Rule 8D(2)(ii) of the I.T. Rules should be deleted. We order accordingly."

Thereafter, it was held by Hon'ble Karnataka High Court as under:-

"The aforesaid shows that the Tribunal has followed a decision of the Bombay High Court in the case of CIT v. HDFC Bank Ltd. [2014] 366 ITR 505/226 Taxman 132 (Mag.)/49 taxmann.com 335 . When the issue is already covered by a decision of the High Court of Bombay with which we concur, we do not find any substantial question of law would arise for consideration as canvassed."

Accordingly, we set aside the order passed by Ld CIT(A) on the issue of disallowance made under Rule 8D(2)(ii) of I T Rules in both the years and direct the AO to delete the disallowance made u/r 8D(2)(ii) of I T Rules.

12. The next issue relates to disallowance made under Rule 8D(2)(iii) out of other expenditure. The Ld. A.R. contended that the disallowance u/s Rule 8D(2)(iii) should be restricted to actual expenditure having nexus with exempt income. In support of this proposition, the Ld. A.R. placed her reliance on the decision rendered by coordinate bench in the case of KARE Electronics & Development Ltd. (ITA 1273/Bang/2018 dated 25.4.2019). The Ld. A.R. submitted that, in the case of the assessee, the bank charges and telephone charges are the only expenditure having nexus with exempt income. She further submitted that the above said contention of the assessee was accepted by Ld. CIT(A) in assessment year 2013-14 and accordingly directed the A.O. to restrict the disallowance under Rule 8D(2)(iii) to bank charges and telephone charges. The Ld. A.R. submitted that the revenue has not filed the appeal challenging the decision of Ld. CIT(A) rendered in assessment year 2013-14 and hence this issue has attained finality. Accordingly, she pleaded that the AO may be directed to restrict the disallowance u/r 8D(2)(iii) to the amount of bank charges and telephone charges debited to the Profit and loss account in these two years.

13. The bench pointed out that the direct expenses are required to be disallowed under Rule 8D(2)(i) and only indirect expenses are required to be disallowed under Rule 8D(2)(iii). The very fact that the A.O. has invoked the provisions of Rule 8D(2)(iii) would show that the A.O. has considered all the expenditure debited in the profit & loss account are indirect expenses. In reply thereof, the Ld. A.R. put up an alternative contention. She said that as per the decision rendered by Delhi Special Bench of ITAT in the case of Vireet Investments Pvt. Ltd. 165 ITD 27, only those investments which have yielded exempt income during the year should be considered for computing average value of investment for the purpose of making disallowance under Rule 8D(2)(iii). Accordingly, she prayed that the A.O. may be directed to follow the decision rendered by the special bench.

14. We heard Ld. D.R. on this issue and perused the record. We find merit in the alternative contentions of the assessee. Accordingly, we direct the A.O. to follow the decision rendered by Delhi Special bench in the case of Vireet Investments Pvt. Ltd. (supra) i.e. the A.O. shall consider only those investments which have yielded exempt income during the year for the purpose of computing average value of investments. Accordingly, the A.O. should recompute the disallowance under Rule 8D(2)(iii) in both the AY 2015-16 and 2016-17.

15. We shall now take up the appeal filed for assessment year 2017-18. This year also falls under the category of abated assessment and hence the A.O. may make addition even in the absence of incriminating material. In this year also, the A.O. has made addition u/s 14A of the Act only. During this year, the assessee earned aggregate exempt income of Rs.2,58,00,533/-,

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which consisted of dividend income of Rs.4,25,247/- and long-term capital gain of Rs.2,53,75,286/-. The A.O. computed disallowance as per Rule 8D. We notice that the manner of computation of disallowance of expenses has been changed completely from AY 2017-18. The AO computed annual average of investments in shares & mutual funds at Rs.140.01 crores and accordingly made disallowance of 1% thereof as per rule 8D which worked out to Rs.1,40,01,732/-. The Ld. CIT(A) also confirmed the same.

16. The Ld. A.R. submitted that the computation provision given under Rule 8D has been substituted in assessment year 2017-18. The new provisions of Rule 8D read as under:-

“8D (2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:—

(i) the amount of expenditure directly relating to income which does not form part of total income; and

*(ii) an amount equal to one per cent of the annual average of the monthly average of the opening and closing balances of the value of investment, income from **which does not or shall not form part of total income** :*

Provided that the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee.”

17. The Ld. A.R. submitted that the assessee has received dividend income exceeding Rs.10 lakhs from shares held in domestic companies during the year relevant to the assessment year 2017-18. According to the newly inserted provision of *Section 115BBDA* of the Act, the assessee shall become “a specified assessee” and hence income tax is payable on the dividend income at the rates specified in sec.115BBDA. Hence, the dividend income is not exempt u/s 10(34) of the Act in the hands of the assessee, since he is a specified assessee. Accordingly, the assessee has claimed exemption of dividend income received from mutual funds only.

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18. The Ld. A.R. submitted that under new Rule 8D, the disallowance is computed @ 1% of the annual average of the monthly average of the opening and closing balances of the value of investment income from which does not or shall not form part of total income. However, the AO has computed average value of investments made both in shares of domestic companies and mutual funds. The Ld A.R submitted that the A.O. should not have considered investments made in domestic companies, since the dividend income earned therefrom is taxable in the hands of the assessee. Accordingly, the Ld. A.R. submitted that the A.O. should have considered only investments made in mutual funds for computing the average value of investment for the purpose of Rule 8D(2) of the I.T. Rules for assessment year 2017-18. The Ld. A.R. submitted that the annual average value of investments whose income is exempt works out to Rs.73,79,660/- and hence the disallowance that is required to be made under Rule 8D(2)(ii) works out to Rs.73,797/- only.

19. We heard Ld. D.R. on this issue and perused the record. A perusal of the amended provisions of Rule 8D, which is extracted above, would show that the annual average of the monthly average of the opening and closing balances of investments shall be worked out on the basis of investments, income from which does not or shall not form part of the total income. In the hands of the assessee, the dividend income is taxable as per the provisions of section 115BBDA during AY 2017-18, since the aggregate amount of dividend earned from shares held in domestic companies has exceeded the threshold limit of Rs.10 lakhs. Hence, for the purpose of computing average value of investment, the A.O. should not have taken the investment made in the shares of domestic companies. Accordingly, we find force in the contention of the Ld. A.R. that the average value of investment should have been computed by the AO by considering only those investments, income

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from which does not or shall not form part of total income. In the case of the assessee, dividend income received from mutual funds alone is exempt.

20. In view of the foregoing discussions, we are of the opinion that there is a flaw in the working made by the A.O. The submissions made by Ld A.R is in accordance with the provisions of amended Rule 8D. Accordingly, we set aside the order passed by the Ld. CIT(A) on this issue and direct the A.O. to recompute the disallowance u/s 8D(2) in accordance with the discussions made (supra).

21. In the result, the appeal filed by the assessee for assessment year 2014-15 is allowed. The appeals filed for other three assessment years are treated as partly allowed.

Order pronounced in the open court on 22nd Dec, 2021

Sd/-
(George George K.)
Judicial Member

Sd/-
(B.R. Baskaran)
Accountant Member

Bangalore,
Dated 22nd Dec, 2021.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.